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C O N F I D E N T I A L SECTION 01 OF 03 BRASILIA 003106

SIPDIS

STATE PLEASE PASS TO USTR
NSC FOR MIKE DEMPSEY
DEPT OF TREASURY FOR FPARODI
USDOC FOR 3134/USFCS/OIO/WH/EOLSON
USDOC FOR 4332/ITA/MAC/WH/OLAC/MWARD
DOT FOR SUSAN MCDERMOTT, CAROLYN COLDREN
STATE PLEASE PASS TO FAA MIAMI FOR MARK RIOS

E.O. 12958: DECL: 12/17/2014

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SUBJECT: BRAZIL: BOEING EXECUTIVES DISCUSS INVESTMENT,
CIVAIR RESTRUCTURING, AND AIRCRAFT SUBSIDIES

REF: BRASILIA 2939

Classified By: DCM PHILLIP CHICOLA BASED UPON REASON 1.4(B) AND (D)

1. (U) THIS CABLE IS BASED UPON INPUT PROVIDED BY ECON, POL,
AND FCS SECTIONS AT AMEMBASSY BRASILIA AND AMCONSULATE SAO
PAULO.

2. (C) SUMMARY AND INTRODUCTION. DURING A NOVEMBER
30-DECEMBER FCS-ORGANIZED GOLD KEY MISSION, BOEING VICE
PRESIDENT THOMAS PICKERING, ACCOMPANIED BY ALEXANDER WATSON
(A CONSULTANT FOR THE FIRM), JOHN WOJICK (LATAM VP FOR
SALES), AND JEFF JOHNSON (VP FOR BUSINESS DEVELOPMENT OF
INTEGRATED DEFENSE SYSTEMS), MET WITH A SERIES OF BRAZILIAN
GOVERNMENT AND PRIVATE SECTOR OFFICIALS IN VARIOUS MEETINGS
IN SAO PAULO, SAO JOSE DOS CAMPOS AND BRASILIA. TOPICS
DISCUSSED DURING THE VISIT INCLUDED THE UPCOMING SHAKEOUT IN
BRAZIL'S CIVAIR SECTOR, DEBT OWED TO BOEING BY VARIG,
POSSIBLE PARTNERSHIPS WITH LOCAL FIRMS, AND POTENTIAL
AIRCRAFT SALES. IN ADDITION, IN THEIR TALKS WITH MFA
INTERLOCUTORS, PICKERING AND WATSON OFFERED THEIR VIEWS ON
ONGOING DISCUSSIONS BETWEEN THE U.S, AND THE EU ON AIRCRAFT
SUBSIDIES AS WELL AS THE STATE OF U.S.-BRAZIL BILATERAL
RELATIONS. END SUMMARY AND INTRODUCTION.

CIVAIR RESTRUCTURING

3. (C) IN THEIR DECEMBER 2 MEETINGS WITH MINISTER OF
DEVELOPMENT, INDUSTRY, AND COMMERCE FURLAN AND OTHER GOB
OFFICIALS, PICKERING, WATSON, AND WOJICK OUTLINED THEIR
THINKING ABOUT THE LIKELY FACTORS THE GOB WILL HAVE TO
CONSIDER IN DECIDING WHETHER TO BAIL OUT THE AILING BRAZILIAN
CARRIER VARIG. VARIG'S TREMENDOUS DEBT BURDEN, THEY MADE
CLEAR, WOULD MAKE IT DIFFICULT TO SAVE THE AIRLINE. (THE
BOEING TEAM'S OVERALL ANALYSIS ALONG THE LINES OF THAT
CONTAINED IN REFTEL) OVERALL, BOEING'S GOB INTERLOCUTORS
WERE RELUCTANT TO COMMENT ON WHAT THEIR GOVERNMENT WOULD
LIKELY DO, THOUGH THEIR BODY LANGUAGE INDICATED THAT VARIG
WAS YET ANOTHER HEADACHE WHICH SOONER OR LATER THEY WOULD
HAVE TO DEAL WITH.

4. (C) GOB VICE-PRESIDENT (AND ALSO DEFMIN) ALENCAR HAD MORE
TO SAY ABOUT THE VARIG PROBLEM. IN HIS DECEMBER 2 MEETING
WITH PICKERING, WATSON ET. AL., ALENCAR MADE THE FOLLOWING
KEY POINTS:

-- THE GOB WANTS VARIG TO SUCCEED, BUT THE SITUATION IS "VERY
DIFFICULT." ALENCAR SAID THAT HE HAD EXAMINED THE COMPANY'S
BOTTOM LINE, AND IT WAS "A HORROR." UNFORTUNATELY, THE
COMPANY PRESIDENT AND THE FOUNDATION THAT GOVERNED VARIG WERE
IN DENIAL, INSISTING THAT EVERYTHING WAS FINE AND REFUSING TO
ENGAGE SUBSTANTIVELY ON POSSIBLE SOLUTIONS WITH GOB,
CREDITORS, EMPLOYEE UNION AND GOL/TAM REPS. IN A RECENT
MEETING HOSTED BY THE GOB, VARIG MANAGEMENT REPS DID NOT SHOW
UP.

-- THE GOB CONTINUED TO BELIEVE THAT THE WAY OUT COULD WELL
INVOLVE TEAMING VARIG UP WITH LOCAL CARRIERS GOL AND/OR TAM,
WITH A PRACTICAL RATIONALIZATION OF DOMESTIC AND
INTERNATIONAL ROUTES AND OTHER RIGHT-SIZING MEASURES.
ALENCAR SAID THE SITUATION HAD REACHED A LEVEL OF GRAVITY
WHERE IT MIGHT WELL BE NECESSARY TO CREATE AN ENTIRELY NEW
SUCCESSOR COMPANY TO VARIG. THE "OLD VARIG" WOULD REMAIN AS
THE VEHICLE FOR JUDICIAL SETTLEMENTS AND LIQUIDATIONS, WHILE
THE NEW COMPANY WOULD BECOME OPERATIONAL IN PARTNERSHIP WITH
ONE/BOTH OF THE OTHER AIRLINES, THOUGH IT WOULD HAVE TO CARRY
ON WITH SOME OF THE OUTSTANDING OBLIGATIONS.

-- THE EMPLOYEE UNIONS AND MANAGEMENT MUST BECOME ENGAGED
WITH EACH OTHER REALISTICALLY ON SUCH ISSUES AS TRANSFER OF
POSITIONS FROM OLD COMPANY TO NEW, DOWNSIZING/BUY-OUT
PROGRAMS, EMPLOYEE RIGHTS, ETC., AND ALENCAR THOUGHT THAT WAS
NOT HAPPENING.

-- ALENCAR WAS SURPRISED BY THE SIZE OF VARIG'S DEBT TO
BOEING, AND STRONGLY URGED BOEING TO USE ITS LEVERAGE WITH
VARIG MANAGEMENT TO URGE THEM TO BECOME SERIOUSLY ENGAGED IN

A NEGOTIATION PROCESS WITH GOB, UNIONS, TAM/GOL WITH A VIEW TO FINDING A SOLUTION. PICKERING AND WATSON UNDERTOOK TO DO SO.

-- THE GOB, TOGETHER WITH ITS NATIONAL DEVELOPMENT BANK (BNDES), WOULD BE WILLING TO HELP BROKER A DEAL AND THEN PROVIDE FINANCING IF THE PROJECT LOOKED VIABLE. THE GOB COULD MOVE WITH ALACRITY IF VARIG MANAGEMENT WOULD ONLY GET ENGAGED, ALENCAR SAID. BUT THE GOB DID NOT/NOT INTEND AN OUTRIGHT BAIL-OUT OF VARIG JUST TO SAVE A GLORIOUS AVIATION NAME AND SYMBOL OF BRAZILIAN PRIDE, HE ADDED.

15. (C) NOTE: BASED UPON RECENT PRESS REPORTING AND POST'S SUBSEQUENT CONTACTS WITH LULA'S CASA CIVIL, IT NOW APPEARS THAT THE GOB WILL MOVE WITH RESPECT TO VARIG SOON AFTER THE BEGINNING OF THE YEAR. OUR CONTACTS WITHIN THE PRESIDENT'S OFFICE TELL US THAT THE GOB IS CURRENTLY CONSIDERING SEVERAL ALTERNATIVES. THE FIRST WOULD BE ISSUANCE OF A PRESIDENTIAL DECREE ALLOWING THE GOB TO INTERVENE IN VARIG, BREAKING UP THE COMPANY AND DISPOSING OF ITS ASSETS. ANOTHER OPTION UNDER CONSIDERATION, WE WERE TOLD, WAS A PRIVATE TAKEOVER, WITH TAM AND GOL DIVIDING UP AS MUCH OF THE COMPANY AS POSSIBLE. STILL UNCLEAR IS WHETHER TAM/GOL WOULD INHERIT THE VARIG PENSION FUND (WHICH ITSELF IS IN DEFICIT) AND WHO WOULD PAY VARIG'S OUTSTANDING DEBT. YET A THIRD VARIANT WOULD BE THE INVOLVEMENT OF A FOREIGN INVESTOR. OUR SOURCE TOLD US THAT NEGOTIATIONS ARE ONGOING WITH AN UNNAMED MAJOR EUROPEAN CORPORATION WHICH IS INTERESTED IN PURCHASING AN INTEREST IN THE CARRIER. PRESUMABLY THIS WOULD BE A MINORITY STAKE AS 20 PERCENT IS THE MAXIMUM FOREIGN OWNERSHIP OF AN AIRLINE ALLOWABLE UNDER BRAZILIAN LAW. WHILE ONE RECENT NEWSPAPER ARTICLE ASSERTED THAT PORTUGUESE CHARTER AIRLINE EURO ATLANTIC WAS IN DISCUSSIONS WITH BNDES FOR THE PURCHASE OF 20 PERCENT OF VARIG, GOB SPOKESMEN TELL US THAT EURO ATLANTIC IS NOW OUT OF THE PICTURE. MEANWHILE, A LOCAL COURT HAS JUST RULED IN FAVOR OF VARIG IN THE LATTER'S 2.5 BILLION REAIS LAWSUIT AGAINST THE FEDERAL GOVERNMENT, ALTHOUGH THE GOB IS APPEALING THIS DECISION. (VARIG'S TOTAL DEBT IS NEAR 7 BILLION REAIS).

AIRCRAFT SUBSIDIES

16. (C) ON DECEMBER 2, THE BOEING DELEGATION HAD A FRIENDLY, INFORMAL BREAKFAST AT THE MINISTRY OF FOREIGN AFFAIRS. PRESENT FOR THE GOB SIDE WERE AMBASSADOR RUY NOGUEIRA (U/S FOR COOPERATION AND COMMUNITIES ABROAD), AMBASSADOR ANTONIO DE AGUIAR PATRIOTA (THE FOREIGN MINISTER'S CHIEF OF STAFF), AMBASSADOR MARIO VILALVA (HEAD OF THE BUSINESS PROMOTION OFFICE), MINISTER PAULO CESAR DE MEIRA DE VASCONCELLOS (U/S NOGUEIRA'S DEPUTY), COUNSELOR RALPH PETER HENDERSON (CHIEF OF THE IMMIGRATION DIVISION), AND FABIO MENDES MARZANO (ADVISOR TO U/S NOGUEIRA).

17. (C) PICKERING MADE THE CASE FOR ELIMINATION OF GOVERNMENT SUBSIDIES TO AIRCRAFT MANUFACTURERS (I.E., AIRBUS) AND URGED THE GOB TO JOIN TALKS ON A MULTILATERAL OECD ACCORD ON AIRCRAFT SUBSIDIES. SUCH AN ACCORD, PICKERING STATED, WOULD HELP FILL THE VOID LEFT AFTER THE USG'S RECENT ABROGATION OF A 1992 BILATERAL 1992 U.S.-EU UNDERSTANDING ON THIS ISSUE. (ABROGATION OF THE 1992 ACCORD COMES IN THE WAKE OF A 1994 WTO DECISION BANNING AIRCRAFT SUBSIDIES AND A WTO CASE FILED BY THE USG THIS YEAR AGAINST EU SUBSIDIES IN VIOLATION OF THAT DECISION.) PICKERING MADE CLEAR THAT BOEING HAD HAD EXTENSIVE CONSULTATIONS WITH USTR ZOELICK ON THIS ISSUE AND THAT THE USG HAD BEEN SUPPORTIVE OF BOEING'S CONCERNS. NOGUEIRA STATED THAT THE GOB WANTED TO BE AT THE TABLE IF ANY MULTILATERAL ACCORD IS TO BE NEGOTIATED, ADDING THAT BRAZILIAN OFFICIALS WERE PRESENT AT RECENT MULTILATERAL/BILATERAL TALKS IN PARIS ON THIS ISSUE.

U.S.-BRAZIL TRADE RELATIONS AND UNSC SEAT

18. (C) SPEAKING PERSONALLY, PICKERING EXPRESSED GENERAL SUPPORT FOR THE GOB'S CAMPAIGN TO GET A PERMANENT UNSC SEAT AND NOTED THAT, BASED UPON HIS EXPERIENCE AS USUN PERM REP, HE THOUGHT THAT UNSC EXPANSION SHOULD BE ACCOMPANIED BY AN AGREEMENT (FORMAL OR INFORMAL) THAT NO UNSC MEMBER WOULD VETO A RESOLUTION NOT INVOLVING ITS OWN COUNTRY UNLESS AT LEAST THREE UNSC MEMBERS WERE PREPARED TO ALSO VOTE NO.

19. (SBU) WITH RESPECT TO TRADE, PATRIOTA MADE CLEAR THAT THE GOB'S CURRENT PRIORITY WAS SUCCESSFULLY CONCLUDING THE DOHA ROUND. HE SAID THAT PRIOR TO THE GENEVA MEETING EARLIER THIS YEAR, MANY WERE LOOKING AT THE G-20 AS AN OBSTRUCTIONIST ELEMENT -- BUT THAT VIEWS HAD CHANGED IN THE WAKE OF THE KEY ROLE THAT BRAZIL PLAYED IN ACHIEVING CONSENSUS ON THE GENEVA FRAMEWORK. TURNING TO THE FTAA, PATRIOTA NOTED THAT TALKS HAD BEEN DIFFICULT UP TO THIS POINT. HE OPINED THAT THERE WERE SEVERAL VIEWS WITHIN THE FOREIGN MINISTRY AS TO NEXT STEPS, BUT ADDED THAT THE PRESIDENT'S VIEW (AND THE VIEW THAT WOULD PRESUMABLY PREVAIL) WAS THAT THE FTAA AS IT CURRENTLY WAS SHAPING UP SIMPLY DID NOT OFFER BRAZIL ENOUGH. IN RESPONSE TO A QUESTION FROM PICKERING ABOUT THE STATUS OF THE MERCOSUR-EU TALKS, PATRIOTA SAID THAT THE SAME WAS TRUE WITH RESPECT TO THOSE NEGOTIATIONS. PATRIOTA CLOSED BY NOTING THAT REPORTS OF DIFFERENCES BETWEEN THE VARIOUS GOB

MINISTRIES ON TRADE POLICY (I.E., THE MINISTRIES OF AGRICULTURE AND DEVELOPMENT/COMMERCE VS. THE MFA) WERE A BIT OVERBLOWN. TO THE EXTENT THAT DIFFERENT AGENCIES HAD DIFFERENT POSITIONS, HE SAID, THIS SIMPLY MIRRORED THE SITUATION IN THE U.S.

DANILOVICH